

State Board of Equalization

OPERATIONS MEMO

For Public Release

No.: 1070

Date: June 7, 1999

**Subject: Cigarette and Other Tobacco Products
Floor Stock Tax - January 1, 1999**

I. General

Background

Proposition 10 "California Children and Families First Initiative" was approved by the voters on November 3, 1998. The initiative added Article 2.5 (commencing with Section 30103) to Chapter 2 of Part 13 of Division 2 of the Revenue and Taxation Code which imposes an additional excise tax on cigarettes of 50 cents per package of 20 cigarettes, imposes an additional excise tax on the distribution of tobacco products equivalent to the additional cigarette tax, and imposes an equivalent compensating floor stock tax, operative January 1, 1999.

As a part of implementing the initiative's floor stock tax provisions, approximately 140,000 sales tax retailers were issued Cigarette and Tobacco Products Dealer Floor Stock Tax accounts based on their current registration information under their sales and use tax account. The sales tax accounts selected were those which have a business code 5, 7, 9, 10, 11, 12, 20, 21, 22, 24, 26, 27, 33, 34, 35, 36, 58, 62, 75, and 76. Also included were any sellers with a business code of 28, 70 or 79 and not on a yearly or fiscal yearly reporting basis were assigned floor stock tax accounts. Field offices will have the ability to issue floor stock tax accounts to retailers that were not identified in the selection process. Field staff will follow the procedures included in Section IV, *Taxpayer's Without A System Generated CTP Account*.

II. Reporting Requirements

Returns

The Administration Department will process all dealer/retailer floor stock tax returns. The Excise Taxes Division will process all cigarette and tobacco distributor floor stock tax returns. Returns for licensed cigarette distributors, who are registered with the Board, may be obtained through the Excise Taxes Division.

Each retailer that was issued a floor stock tax account was mailed a Cigarette and Tobacco Products Dealer Floor Stock Tax Return, BOE-401-Q, on or about December 15, 1998. The return requires the retailer to report and pay the floor stock tax on their inventory as of 12:01 A.M. on January 1, 1999. The return provides for separate calculations of the floor stock tax on cigarettes based on different package sizes and the floor stock tax on other tobacco products. The return was due on or before February 15, 1999. A penalty of 10% plus interest is due on payments filed after that date. Attachment A is a sample floor tax return.

A small supply of blank floor stock tax returns was provided to the district offices for use when a taxpayer contacts them regarding payment of the floor stock tax. The floor stock tax returns may also be printed from the Registration Print Sub-System. Not all sellers of cigarettes and tobacco products were identified in our initial selection of accounts. Some of those who were missed will identify themselves and want to report and pay the floor stock tax. These accounts should be issued an arbitrary account number and be provided a floor stock tax return from the Registration Print Sub-System. All returns must be sent to the Headquarters Cashier for processing.

III. Follow-up Notices and Billings

Delinquency Notice

Dealer floor stock returns are scheduled to be loaded into IRIS in May 1999. Billings for the no remittance and partial remittance returns will be created and sent at that time. Also, cigarette and tobacco product accounts that have not filed their returns will be sent delinquency notices. The delinquency notice will include another return form for the retailer's use in reporting the floor stock tax. Returns filed, as a result of the delinquency notice should be processed in the same manner as returns otherwise filed. There will not be a second delinquency notice for the Dealer Floor Stock Tax Returns.

Accounts Receivable Billings

Returns filed either without a remittance or with only a partial remittance will be billed by the Return Analysis Section, Return Processing Section. The section will also issue billings for late payments, dishonored checks, tax shortages and requests for relief of penalty (ROP). The Return Analysis Section, Return Processing Section will initiate refunds of overpayments resulting from computational errors on the tax return. Overpayments and requests for refunds resulting from taxpayer identified reporting errors will be referred to the Excise Tax Division, Audit Section for review and disposition.

IV. Taxpayers Without A System Generated CTP Account

There are taxpayers who should have been assigned a CTP Account Number that were not originally assigned an account number by the system in December 1998. When those taxpayers contact the Board, the district of control will assign an arbitrary CTP account number. Once the arbitrary number has been assigned, a CTP Floor Stock Tax Return can be generated from the Registration Print Sub-System. The Registration Print Sub-System may also be used to replace floor stock tax returns that have been misplaced or not received via the mail.

V. Headquarters Procedures

Cashier Unit

The Cashier Unit is currently batching and holding zero (no money due) returns. They are batching and processing money (non-remittance, partial remittance and fully paid) returns. Because IRIS does not have the ability to accept the CTP tax program and the associated returns and payments, the Cashier Unit, will batch the money returns together. The Cashier Unit will create a spreadsheet for each batch that will identify each account by number and the amount paid for each return for that batch. Once the programs have been developed for IRIS to accept the tax program, financial obligations and delinquencies will be established by the system for those system generated CTP account numbers. A list of the arbitrary accounts will be generated and manually checked to ensure that the CTP returns were filed and paid timely. If a Financial Obligation exists on an arbitrary account, the appropriate field office will be notified. When the Cashier Unit receives a CTP return with a Sales Tax account number, they contact Compliance Planning and Evaluation Section (CPE). CPE in turn will issue the CTP arbitrary number and relay that number back to the Cashier Unit.

Key Data Entry (KDE)

KDE will key the number of packages of cigarettes and the dollar amount of tax indicated on that line for that calculation. KDE will also key the wholesale dollar amount of other tobacco products and the amount the taxpayer calculated using the indicated percentage. KDE will key the total lines, which could include penalty and interest. IRIS will do a calculation to determine if the taxpayer has indicated the proper amount of floor stock tax to pay for the cigarettes and for other tobacco products. If there is an error in the calculation, the Return Analysis Section, Return Processing Section will be notified and the appropriate notice will be sent to the taxpayer.

Return Analysis Section

The Return Analysis Section will process the CTP returns as they do the sales tax returns.

I. VI. Excise Taxes Division, Cigarette and Tobacco Products Distributor

Cigarette Distributors

Each licensed cigarette distributor will be required to take an inventory of his or her stock of packages bearing stamps and of unused stamps, and are required to pay a floor stock tax on all affixed and unaffixed stamps in their possession or under their control as of 12:01 a.m. on January 1, 1999.

Unusable tax stamps affixed to packages to be returned to out-of-state manufacturers and damaged stamps on carton flaps; etc. should be included in this inventory.

A Cigarette Distributor Floor Stock Tax and Cigarette Stamp Adjustment Tax Return, Form BOE-501-Q2 (Attachment B) for reporting cigarette tax stamps adjustments was sent to distributors. The return has a due date of February 15, 1999.

Licensed cigarette distributors who are also dealers will inventory and pay the floor stock tax for cigarettes on hand at all of their California retail outlets.

Tobacco Products Distributors

Distributors of tobacco products must report and pay the floor stock tax on their stocks of tobacco products purchased from an instate distributor or wholesaler which are included in their retail inventory stock at their California locations at 12:01 a.m. on January 1, 1999. Tobacco products, which have not been previously distributed in California, are not subject to the floor stock tax. A Tobacco Products Distributor Floor Stocks Tax Return, Form BOE -501-Q5 (Attachment C) will be sent to distributors for reporting purposes. The return will have a due date of February 15, 1999.

Separate accounting records must be maintained of tobacco products for their retail stocks and for their warehouse stocks not subject to the floor stock tax. Ex-tax tobacco products withdrawn from centralized warehouse stocks for delivery to retail outlets will be considered distributed when withdrawn.

Tobacco products distributors who are also dealers, are required to inventory and pay the floor stock tax for tobacco products on hand at all of their California retail outlets.

Return Processing

Existing procedures pertaining to cashiering and batching will be utilized for the cigarette and tobacco products floor stock tax returns. This includes mail opening, check and return batching.

Floor stock returns for distributors will be verified and reviewed for billing and delinquency control by the Excise Taxes Division after the cashier function.

Delinquency notices for Distributors will be mailed in April 1999. A second delinquency notice or Final Notice for Distributors could be sent by the end of May 1999 if necessary.

There may be instances where the taxpayers receive two floor stock tax returns. They could receive a dealer return and a distributor return. If the taxpayer has received both returns, the distributor should report and pay all retail outlet floor stock tax on the dealer return and all other floor stock tax (warehouse stock) on the distributor return.

VII. Audit Procedures, Excise Taxes Division

Audit Responsibilities, Excise Taxes Division

Due to the substantial increase in taxes and the large volume of accounts, the auditor should verify whether floor stock taxes were reported and paid for each account under audit.

It is the auditor's responsibility to determine if the account is subject to the floor taxes. A review of the taxpayer's inventory records may be necessary to determine if the taxpayer maintained an inventory subject to the floor stock taxes on the date of the increase. All floor stock inventory liabilities due should be verified as properly reported and paid, including damaged stamps. A review of the taxpayer's floor stock return worksheets, financial statements, and their month ending inventory levels may assist the auditor in the verifying the amount of the floor stock tax reported.

Audit Procedure, Excise Taxes Division

Additional tax liability resulting from verifications of the floor stock taxes on inventories will be reported on a BOE-414-SP, Field Billing Order.

Section 30207 (Statue of Limitations) of the Cigarette and Tobacco Products Law, which provides for the statue of limitations, will apply to the floor stock taxes. Penalties described in Sections 30204 (Penalty) and 30205 (Fraud Penalty) shall be included in these field-billing orders, as determined applicable by the auditor. Interest as provided in Section 30202 (Interest) will apply to these field-billing orders. Jeopardy determination provisions, provided in Section 30241 (Basis of Determination) apply to floor stock taxes.

VIII. Cigarette Tax Evasion

Cigarette Tax Enforcement Team

With the passage of Proposition 10 and the increased tax on cigarette and tobacco products, the possibility of cigarette and tobacco products tax evasion may increase. The Board may receive tips, leads, and/or complaints regarding person(s) offering unstamped cigarettes and untaxed tobacco products for sale. Staff receiving tips, leads, or complaints, should document all related facts and forward them to the Cigarette Tax Enforcement Team, Investigations Division, MIC: 42, for investigation.

IX. Obsolescence

This Operations Memo will become obsolete when the cigarette and other tobacco products floor stock tax program is concluded.

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Distribution 1D

Attachments